

THE FEDERAL TAXATION OF LEGAL EDUCATION: PAST, PRESENT, AND PROPOSED

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Admiral H. G. Rickover, in his recent thesis on American education, has warned the nation that in order that it be assured of enough educated people our society will have to underwrite at least part of the cost of higher education.¹ A tax-supported school system offers itself as one approach to this problem.² Unfortunately, however, legal education only in rare instances has attracted the great, tax-deductible endowments often left for other purposes; nor has it received substantial amounts of governmental support.³ In addition, the question of the deductibility of expenses incurred in obtaining a legal education, basic as well as continuing, has been accompanied by uncertainty and confusion, and compounded by a vast diversity of factual situations which have given rise to these controversies.⁴

In the last few years, the United States has become increasingly conscious of its educational program and policies.⁵ This concern has been stimulated by cold war developments and the apparently increased power of the Soviet Union relative to the United States.⁶ Simulta-

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¹ Rickover, *American Education—A National Failure* 243 (1963).

² A clearly defined answer to the problems of increasing school revenues is hard to find. Local taxation has just about hit the saturation point causing schoolmen, who recognize the acute need, to look more to state and federal support. "How Broad Should a Broadened Tax Base Be?" 71 *Nation's Schools* 65 (1963).

³ Crotty, "Law School Salaries—A Threat to Legal Education," 6 *Legal Ed.* 166, 169 (1953).

⁴ Crane, "Law School Education Expenses After *Welsh v. United States*," 11 *Loyola L. Rev.* 307 (1963); Goldman, "Recent Decision on Educational Expenses Arouses Controversy; Liberal Trend Slowed," 17 *J. Taxation* 40 (1962); Ruffner, "Deductibility of the Expenses of Obtaining a Law Degree," 17 *U. Miami L. Rev.* 424 (1963).

⁵ See, e.g., Commission on Financing Higher Education, *Nature and Needs of Higher Education* (1952); Conant, *The American High School Today* (1959); Conference on Legal Education, *The Law Schools Look Ahead* (1959); Harno, *Legal Education in the United States* (1953); Harris, *Higher Education Resources and Finance* (1962); Keezer, *Financing Higher Education: 1960-1970* (1959); Machlup, *The Production and Distribution of Knowledge in the United States* (1963); Nicholson, *The Law Schools of the United States* (1958); Warkov, *Lawyers in the Making: The 1961 Entrants to American Law Schools* (1963); Becker, "Underinvestment in College Education?" 50 *Am. Econ. Rev.* 346 (1960); Harno, "American Legal Education," 46 *A.B.A.J.* 845 (1960).

⁶ Note, "Federal Tax Incentives for Higher Education," 76 *Harv. L. Rev.* 369 (1962).

neously, it has been recognized that sending children to college involves for most families an extraordinary financial burden, and that this burden will grow as hard-pressed institutions find it necessary to increase tuitions in order to support higher faculty salaries and other increased costs.⁷

Since 1920 the enrollment in higher education has increased 500 percent, while law school enrollment has increased less than 75 percent.⁸ A 1960 American Bar Association survey found that only slightly over two million dollars was available for law scholarships throughout the country, nine schools controlling more than half of these funds.⁹ Despite the lag of financial support for legal education, relative to higher education generally, law degrees awarded rose from 7,937 in 1955 to 9,073 in 1960. Less than one-third of this number received public support.¹⁰ It is estimated that for the 1967-70 period the net cost of a three-year law school education will be 9,000 dollars,¹¹ and some now urge that federal aid is inevitable.¹²

In the first session of the 87th Congress, a variety of bills seeking to grant tax relief to students or their parents were introduced;¹³ this year, a tax credit proposal which would have provided certain tax benefits to parents paying college tuition and fees for their children was narrowly defeated. A companion bill was also defeated in a tie

⁷ United States President's Committee on Education Beyond High School, Second Report to the President 11 (1957). The U.S. Office of Education, in a new study, says that between the 1958-59 and the 1962-63 school years, the median tuition for undergraduates at 851 private colleges and universities rose from \$534 to \$740; among 514 state colleges and universities studied, the median increase was \$49 for state residents and \$11 for out-of-state residents. The survey found that fewer than one in five private institutions were able to hold increases to \$100 or less. See generally *Economics of Higher Education* (Mushkin ed. 1962), covering a wide range of problems, including the nation's requirements for college-trained people, and detailed questions of financing.

⁸ See ABA Special Committee to Study Current Needs in the Field of Legal Education 4 (1961); cf. Smith, "Admissions to the Bar in 1958 and 1959: Has the Downward Trend Been Reversed?" 46 A.B.A.J. 1201 (1960).

⁹ ABA Special Committee to Study Current Needs in the Field of Legal Education 11 (1961); Note, "Modern Trends in Legal Education," 64 Colum. L. Rev. 710, 732 (1964).

¹⁰ *Ibid.*

¹¹ Cavers, "A Proposal: Legal Education in Two Calendar Years," 49 A.B.A.J. 475, 480 (1963).

¹² Note, "Federal Tax Incentives for Higher Education," *supra* note 6; But see N.Y. Times, July 19, 1964, p. E7, col. 1, for the new platform of the Republican party cutting school aid proposals.

¹³ H.R. 331, H.R. 1836, H.R. 1837, H.R. 3521, H.R. 3549, H.R. 7379, H.R. 8717, H.R. 9067, H.R. 9222, H.R. 9373, 87th Cong., 1st Sess. (1961). See generally Meck, "The Tax Credit Proposal," *Higher Education in the United States* 93 (Harris ed. 1960).

vote. That bill would have provided for the income tax exemption of the first 1,200 dollars of the annual earnings of undergraduates, and 1,500 dollars of the earnings of post-graduate students.¹⁴

We will examine both the federal tax aspects of education expenses and the suggestion that those expenses be amortized.¹⁵

DEDUCTIBILITY OF EDUCATIONAL EXPENSES

With increased awareness of the value of a more learned citizenry, allowing the deductibility of educational expenses has received added attention.¹⁶ The Internal Revenue Service normally denominates such expenditures personal and thus nondeductible under the Internal Revenue Code,¹⁷ while taxpayers fight to treat them as deductible business expenditures.¹⁸ To be deductible, the expenses must be "ordinary and necessary,"¹⁹ and the taxpayer must be engaged in a trade or business.²⁰

In general, the theory of the Treasury Regulations is that in order for any educational expense to be deductible it must *either* be (1) incurred to maintain or improve skills required by the taxpayer in his employment or other trade or business, or (2) be an express requirement of the taxpayer's employer or applicable law or regulations, imposed as a condition to the retention of the taxpayer's salary, status, or employment.²¹ If it is "customary for other established

¹⁴ N.Y. Times, Feb. 4, 1964, p. 1, col. 2.

¹⁵ The 1953 proposal appears to have been revived. See Goode, "Educational Expenditures and the Income Tax," *Economics of Higher Education* 281 (Muskin ed. 1962). See also the recommendation of Carrol G. Josselyn during the 1953 General Revenue Revision hearings before the House Ways and Means Committee. *Hearings Before the Committee on Ways and Means*, 83d Cong. 1st Sess., pt. 1, at 189 (1953).

¹⁶ Chommie, "Federal Income Taxation: Transactions in Aid of Education," 58 Dick. L. Rev. 291 (1954); Chommie, "Services Rendered, Not Donative Intent, Governs Exemption of Study Grants," 4 J. Taxation 375 (1956); Harrington, "The Deductibility of Education Expenses Under § 162(a) of the Internal Revenue Code," 4 William & Mary L. Rev. 55 (1963); Loring, "Some Tax Problems of Students and Scholars," 45 Calif. L. Rev. 153 (1957); Shaw, "Education as an Ordinary and Necessary Expense in Carrying on a Trade or Business," 19 Tax L. Rev. 1 (1963); Note, "Deduction of Educational Expenses Under the Internal Revenue Code of 1954," 1 Washburn L. Rev. 440 (1961).

¹⁷ Int. Rev. Code of 1954 § 262.

¹⁸ Int. Rev. Code of 1954 § 162(a).

¹⁹ *Ibid.*

²⁰ *Trent v. Commissioner*, 291 F.2d 669 (2d Cir. 1961). Originally, the phrase "trade or business" was synonymous with any profit-seeking activity. Allen & Oreckhoff, "Toward a More Systematic Drafting and Interpreting of the Internal Revenue Code: Expense, Losses, and Bad Debts," 25 U. Chi. L. Rev. 43 (1957).

²¹ Treas. Reg. §§ 1.162-5(a) (1) & (2) (1958); Rev. Rul. 60-97, 1960-1 Cum. Bull. 69.

members of the taxpayer's trade or business to undertake such education, the taxpayer will ordinarily be considered to have undertaken this education for the purpose of maintaining or improving a skill required of him in his employment or other trade or business,"²² although "no deduction is allowed for expenses which are for education undertaken primarily for the purpose of obtaining a new position, or primarily for the purpose of fulfilling the general aspirations or other personal purposes of the taxpayer."²³

The Treasury view dates back to 1921. Two rulings then declared summer school expenses of teachers and postgraduate courses for doctors to be personal undertakings and nondeductible.²⁴ Five years later in 1926, the Board of Tax Appeals held voice study expenses of instruction, travel, and subsistence in anticipation of professional employment to be personal and nondeductible.²⁵ In 1933, dictum of Mr. Justice Cardozo in *Welch v. Helvering* generated much of the difficulty in this area of the federal taxation of educational expenses:

[A] man conceives the notion that he will be able to practice his vocation with greater ease and profit if he has an opportunity to enrich his culture *Reputation and learning are akin to capital assets*, like the good will of an old partnership The money spent in acquiring them is well and wisely spent. It is not an ordinary expense of the operation of a business.²⁶

The case involved a commercial transaction, and the discussion of educational costs was merely by way of analogy. Justice Cardozo spoke of that knowledge which is obtained for its own sake as an addition to one's cultural background or for possible use in some future work; he did *not* indicate that he would make no exception where the skill acquired was needed for one's present vocation.²⁷

Using Justice Cardozo's "capital asset" conceptualization, it can be argued that education has an enduring quality; a professor who invests in an advanced degree should be treated as a factory owner who adds plant capacity.²⁸ Each builds foundations of learning, upon which their future and earnings are to be based. Yet if education or training is undertaken to prepare oneself for a new vocation or profession, or to meet the minimum qualifications for any employment,

²² Treas. Reg. § 1.162-5(a) (1958); Rev. Rul. 60-97, 1960-1 Cum. Bull. 69.

²³ Treas. Reg. § 1.162-5(b) (1958); Rev. Rul. 60-97, 1960-1 Cum. Bull. 69.

²⁴ O.D. 892, 1921-4 Cum. Bull. 209; O.D. 984, 1921-5 Cum. Bull. 171.

²⁵ T.F. Driscoll, 4 B.T.A. 1008 (1926).

²⁶ *Welch v. Helvering*, 290 U.S. 111, 115-16 (1933). (Emphasis added.)

²⁷ See *Coughlin v. Commissioner*, 203 F.2d 307, 309 (2d Cir. 1953).

²⁸ *James M. Osborn*, 3 T.C. 603 (1944); *Richard H. Lampkin*, 11 CCH Tax Ct. Mem. 576-77 (1952); G.C.M. 11657, XII-1 Cum. Bull. 250 (1933).

there is no deduction.²⁹ The Code does give some relief by excluding scholarship and fellowship aid from taxable income,³⁰ and parents may claim a 600 dollars exemption for children over 19 years of age who are students, if they receive more than half their support from the parents (even if the children have gross income exceeding 600 dollars).³¹

The broad issue is ordinarily whether the particular expense of education is a personal, capital, or the previously mentioned "ordinary and necessary" expense of the taxpayer's professional activity.³² While it sometimes appears to be conceded that educational expenses, following the Cardozo dictum in *Welch*, are in the nature of capital expenditures, the courts have not always been consistent in classifying such expenditures. Presently, however, drawing a distinction between personal and capital expenses is immaterial because neither generates a deduction.

In *James M. Osborn*³³ the Tax Court disallowed the deduction of an educational expense partially on the theory that it was a nondeductible capital expenditure. The taxpayer was a research professor at Yale who received no compensation while he was engaged in literary research. Most of his time was devoted to the preparation of three books. Osborn had no immediate prospect of financial profit, but he did hope to build a reputation for first class scholarship, thus making himself eligible for highly remunerative professional appointments. In 1940 he spent some 7,000 dollars on literary research in producing the books. One of the books was distributed free; another was published at the taxpayer's expense in a limited edition; and the third, unpublished, was expected to show a profit. The Tax Court, citing Justice Cardozo's dictum, said these expenses were "in essence the cost of the capital structure from which his future income is to be derived." The court added "that they cannot be given deductibility for tax purposes in the absence of legislation, where alone deductibility can be provided."³⁴

Although the era of reflexive denials of deductions for educational expenses ended in 1950 when the Fourth Circuit Court of Appeals permitted schoolteacher Nora Payne Hill to deduct her summer

²⁹ Rev. Rul. 60-97, 1960-1 Cum. Bull. 69, 73.

³⁰ Int. Rev. Code of 1954 § 117.

³¹ Int. Rev. Code of 1954 § 151.

³² See Chommie, "Federal Income Taxation: Transactions in Aid of Education," *supra* note 16.

³³ 3 T.C. 603 (1944).

³⁴ *Id.* at 605.

school expenses,³⁵ the Tax Court still kept the door closed to most such deductions.

Knut F. Larson became employed as a mechanic in 1942 with a company that had suffered a wartime-shortage of skilled personnel. In September 1943, he registered in the New York University, Evening Division, School of Engineering, where he thereafter took evening courses. He continued to work for the same company, and in 1945 was employed as an industrial engineer. He received his degree of Bachelor of Administrative Engineering in 1948. In disallowing Larson's petition for redetermination the Tax Court again repeated Justice Cardozo's dictum. Larson himself had claimed that his studies and the subsequent academic award would account for increases in his earning capacity. Since neither the Internal Revenue Code nor the Treasury Regulations expressly provide that educational costs are to be treated as capital items,³⁶ and since the court found that the learning was "akin to capital assets," the expenses were nondeductible.³⁷

Richard Lampkin was a college professor. He objected to the assessment of a deficiency resulting from the disallowance of an amount which he had expended in connection with his doctoral dissertation.³⁸ The Tax Court itself suggested that capitalization of the expenditures might be proper with current recoupment limited to an annual offset against receipts. This is analogous to a previously permitted method of amortizing of patents.³⁹

We can see from these illustrative Tax Court cases that on several occasions the capital nature of education has been recognized. It was with regard to legal education that the capital asset concept received its initial setback.

In *Coughlin v. Commissioner*⁴⁰ the Tax Court affirmed a deficiency assessment disallowing the expenses on the grounds that they were educational and personal and, as such, were not allowable deductions for federal income tax purposes. Petitioner Coughlin was a lawyer engaged in general practice, but he handled some matters pertaining to federal taxation. Coughlin regularly attended bar association lectures designed to keep the practitioner informed on current developments in

³⁵ *Hill v. Commissioner*, 181 F.2d 906 (4th Cir. 1950), *reversing* 13 T.C. 291 (1949).

³⁶ See Comment, "Deductibility of Educational Expenses," 6 Stan. L. Rev. 547, 548 n.7 (1954). The costs of basic college education and professional training are not deductible. *Lewis v. Commissioner*, 164 F.2d 885 (2d Cir.), *affirming* 8 T.C. 770 (1947); *T.F. Driscoll*, 4 B.T.A. 1008 (1926); *J.D. Bowles*, 1 B.T.A. 584 (1925).

³⁷ *Knut F. Larson*, 15 T.C. 956 (1950).

³⁸ *Richard H. Lampkin*, 11 CCH Tax Ct. Mem. 576 (1952).

³⁹ See *Associated Patentees, Inc.*, 4 T.C. 979 (1945).

⁴⁰ *Supra* note 27.

the law. His firm regularly subscribed to various publications, periodicals, and services related to the field of federal taxation;⁴¹ Coughlin was expected by his partners to keep abreast of the changes and developments of the law.

In November 1946, Coughlin attended an institute on federal taxation, sponsored by the Division of General Education of New York University. The institute was aimed specifically at people who had done tax work and who had a certain amount of expertise in taxation.⁴² Students were told that the institute was not designed for their benefit. In 1946, the institute was attended by 408 attorneys, accountants, and others, such as trust officers and corporate executives. It was intended by its sponsors to expose legal practitioners to trends, thinking, and developments in the field of federal taxation.

In *Coughlin* the court relied on *Hill v. Commissioner*,⁴³ which had allowed the summer school expenses of teachers; however, the Tax Court pointed out that *Hill* was limited "to the facts before the court." It sustained the Commissioner who had based his case on the old 1921 Office Decision disallowing doctors' deductions for postgraduate courses,⁴⁴ and cited Justice Cardozo's dictum to support its holding. The court of appeals said that if the expenses were "directly connected with" or "proximately resulted from" Coughlin's practice of his legal profession they would be deductible.⁴⁵ The court said further that if it were usual for lawyers in practices similar to Coughlin's to incur such expenses they would be "ordinary,"⁴⁶ and if appropriate and helpful, "necessary."⁴⁷

⁴¹ In *Julius I. Peyser*, 1 CCH Tax Ct. Mem. 807 (1943), a lawyer was allowed the cost of "current legal publications of short life," and a portion of the upkeep and expenses of a car used partly in his business.

⁴² A lawyer may deduct the cost of a two-week course in federal taxation at the Practising Law Institute in New York. In July 1948, F.M. Bistline and his wife traveled to New York City, where he enrolled in the tax course and also attended the Lions' Convention. His travel expenses for the trip to New York and his hotel expenses incurred while attending the Institute amounted to \$295.20. It was undisputed that his expenditures for tuition and books totaled \$140. The District Court in Idaho held these amounts deductible as business expenses. *Bistline v. United States*, 145 F. Supp. 800 (D. Idaho 1956).

⁴³ *Supra* note 35. See *Bowen*, "Teachers and Taxes," 32 *Taxes* 57 (1954).

⁴⁴ O.D. 984, 1921-5 Cum. Bull. 171.

⁴⁵ *Coughlin v. Commissioner*, *supra* note 27.

⁴⁶ An expense is "ordinary" if it is "normal, usual, or customary." *Deputy v. Dupont*, 308 U.S. 488, 495 (1939); *National Brass Works, Inc. v. Commissioner*, 182 F.2d 526, 530 (9th Cir. 1950).

⁴⁷ "Necessary" has been defined liberally by the Supreme Court to mean "appropriate and helpful" rather than "indispensible or required." *Welch v. Helvering*, 290 U.S. 111 (1933). See *Shaw*, *supra* note 16, at 2.

In reversing the Tax Court, the Second Circuit held that Coughlin's situation was closely akin to that of Nora Hill, the schoolteacher, and that the only difference was in the degree of necessity which prompted the incurrence of the expenses. Nora Hill would have been unable to retain her position as a schoolteacher unless she had complied with the school's requirements for the renewal of her teaching certificate, and an optional way to do that was for her to attend summer school at a recognized institution of learning. Here, while Coughlin did not need to renew his license to practice as an attorney, and while it may be assumed that he could have continued as a member of his law firm irrespective of whether or not he kept currently informed on his federal tax law, he was "morally" bound to keep so informed and he did so in part by attending the New York University Tax Institute.

The court of appeals, however, distinguished these expenditures from those made to acquire a capital asset.⁴⁸ While recognizing Justice Cardozo's capital analogy, the Second Circuit held that "the rather evanescent character of that for which the petitioner spent his money deprives it of the sort of permanency such a concept embraces."⁴⁹ The case does not establish a minimum test but merely holds that a particular fact, *i.e.*, moral compulsion, constitutes sufficient necessity for deductibility.

In view of the "evanescent character" of this continuing legal education, an argument has been advanced against Justice Cardozo's capital asset analogy.⁵⁰ The ground for the criticism rests on the reasoning that if the peculiar characteristic of a capital asset is its endur-

⁴⁸ Coughlin v. Commissioner, *supra* note 27. One of the most prolific sources of tax litigation has been the problem of distinguishing capital expenditures from revenue charges. Sugarman, "Basic Criteria for Distinguishing Revenue Charges from Capital Expenditures in Income Tax Computations," 49 Mich. L. Rev. 213 (1950); World Tax Series, Taxation in the United States 455 (1963).

⁴⁹ Coughlin v. Commissioner, *supra* note 27. Professor Chommie has critized the court for not having been more explicit in either accepting or rejecting the capital expenditure concept. He also does not believe that the Court was serious in echoing the fairly common sentiment that tax knowledge is "evanescent." Chommie, "Federal Income Taxation: Transactions in Aid of Education," *supra* note 16, at 301.

⁵⁰ One argument points to the analogy of good will; advertising services are deductible as "ordinary and necessary" but the end product which it produces, *i.e.*, good will, is considered as a capital item. Comment, "Deductibility of Educational Expenses," 6 Stan. L. Rev. 547, 550 (1954). Another writer makes the tenuous distinction that since tax law changes so frequently, the education that is acquired is too temporary in character to be considered a capital asset, but that the cost of an attorney taking a course in the new Uniform Commercial Code could be considered to be more "capital" in nature. Note, "Cost of Tax Course Deductible as a Business Expense," 102 U. Pa. L. Rev. 138, 141 (1953).

ing quality, why should it be necessary for some lawyers and other professionals to take annual refresher courses? The reasonable inference would be that whatever is gained loses its value in the period of a year. Since professional law journals and law books having a short useful life are deductible⁵¹ and since a refresher course serves the same function and usually has a shorter useful life, the courses will have to be analyzed to determine the permanence of the knowledge acquired and the extent to which it has improved the taxpayer's capacity in his field of endeavor.

PRIZES, AWARDS, SCHOLARSHIPS, AND FELLOWSHIPS

The Treasury has changed its approach which seems to indicate a shift in emphasis with regard to prizes, awards, scholarships, and fellowships; they have been accorded specialized treatment. Prizes and awards are, with certain stated exceptions, specifically included in income, whereas scholarships and fellowship grants are, with stated exceptions, specifically excluded from income.⁵²

Statutory regulation clarifying the tax treatment of prizes and awards was deemed necessary in the Code⁵³ because of certain decisions which had previously held prizes awarded in a contest to be nontaxable gifts rather than taxable income.⁵⁴ The doctrine of consideration was the test under the law prior to the 1954 Code which led to the conclusion that a nontaxable gift was received when the lucky winner did nothing substantial to merit the prize.⁵⁵

The American Bar Association awarded its Ross Essay Prize for 1939 to Malcolm McDermott. The Commissioner ruled that the prize was taxable as income and the Tax Court sustained the Commissioner.⁵⁶ McDermott, a professor of law, submitted his essay on a topic chosen by the association. The judges considered McDermott's essay to be the best and he was awarded the prize and a certificate.⁵⁷ In reversing the

⁵¹ Louis Boehm, 35 B.T.A. 1106 (1937). See note 41 *supra*. The Commissioner permits a life in excess of one year. Dean, "Tax Ideas for Professional Persons," P-H Tax Ideas ¶ 5003 (1956). Waisel, "Attorneys' Federal Income Taxes," 66 Dick. L. Rev. 75 (1961); Note, "The Determination of Depreciation Allowances on Professional Libraries for Income Tax Purposes," 9 Tax L. Rev. 102 (1953).

⁵² Int. Rev. Code of 1954, § 74; Treas. Reg. § 1.74-1(a) (1955).

⁵³ See Senate Finance Committee Report, 83d Cong., 2d Sess. (1954); Loring, "Some Tax Problems of Students and Scholars," 45 Calif. L. Rev. 153, 157 (1957).

⁵⁴ McDermott v. Commissioner, 150 F.2d 585 (D.C. Cir. 1945); Pauline L. Washburn, 5 T.C. 1333 (1945).

⁵⁵ Mansfield, "Income from Prizes and Awards and from Scholarships and Fellowship Grants," 19 N.Y.U. Inst. on Fed. Tax 129, 130 (1961).

⁵⁶ Malcolm McDermott, 3 T.C. 929 (1944).

⁵⁷ The American Bar Association was regarded as the payor, and since its intent was

Tax Court, the District of Columbia Court of Appeals listed eight circumstances which required the conclusion that the award was a gift and not taxable.⁵⁸ Included among them was the recognition that it had become a wise and settled policy to exempt such awards from taxation in order to encourage scholarly work. The Treasury refused to agree, and subsequent cases have uniformly held that prizes for essays in a contest are taxable.⁵⁹

As a result of the decision in *McDermott*, and another decision, *Pauline L. Washburn*,⁶⁰ in which the taxpayer was a winner on the Pot of Gold radio program even though she had not been tuned in to the broadcast, Congress decided to change the rules.⁶¹ The Internal Revenue Code of 1954 now provides that amounts received as prizes and awards are included in "gross income."⁶² There are two exceptions to this general rule: (a) a prize or award "made primarily in recognition of religious, charitable, scientific, educational, artistic, literary or civic achievement," but only if the taxpayer was selected without having done anything or taking any action to enter the contest, and provided also that he or she is not required to do anything "substantial" by way of future services before becoming entitled to receive the prize or award; (b) scholarships and fellowship grants.⁶³ As examples of the first exception, the Treasury Regulations say that "such awards as the Nobel prize and the Pulitzer prize would qualify for the exclusion."⁶⁴

The second exception to the rule of includability is not truly an exception since it receives special treatment in a separate provision of the Internal Revenue Code.⁶⁵ Scholarships and fellowship grants are now regulated by statute for the first time in the 1954 Code.

Prior to the enactment of section 117 of the 1954 Code, which now controls the entire question of the taxability of legal and other scholarship and fellowship grants,⁶⁶ the tax struggle revolved around

donative and the motive of the taxpayer was nonpecuniary, the award was classified as a gift. See Note, "Scholarships, Fellowships and Prizes: Gift or Income?" 38 Minn. L. Rev. 152, 159 (1954).

⁵⁸ *McDermott v. Commissioner*, 150 F.2d 585, 586 (D.C. Cir. 1945).

⁵⁹ I.T. 3960 1949-2 Cum. Bull. 13; *United States v. Amirikian*, 197 F.2d 442 (4th Cir. 1952); *Mansfield*, *supra* note 55, at 131.

⁶⁰ 5 T.C. 1333 (1945).

⁶¹ See S. Rep. No. 1622, 83d Cong., 2d Sess. 178 (1954).

⁶² Int. Rev. Code of 1954 § 74(a).

⁶³ Int. Rev. Code of 1954 § 74(b). See Treas. Reg. § 1.74-1(b) (1955); Rev. Rul. 57-19, 1957 Int. Rev. Bull. No. 3, at 7.

⁶⁴ Treas. Reg. § 1.74-1(b) (1955).

⁶⁵ Int. Rev. Code of 1954 § 117.

⁶⁶ Note, "Fellowships and Scholarships, Prizes and Awards—Ante 1954, Post 1954," 7 Syracuse L. Rev. 130 (1955).

the question of whether the grant constituted a gift which was exempt from income taxation. The Internal Revenue Code of 1939 contained no provision comparable to section 117. Under the 1939 Code the typical approach was to determine whether or not the amounts so received fell within the statutory definition of gross income. Taxation depended upon whether or not the amounts received were intended as compensation for services rendered.⁶⁷ If it could be shown that the amounts received were, in fact, gifts under section 22(b)(3) of the 1939 Code, recipient did not have to include them in his gross income; if such grants were determined to be in the nature of compensation, then the opposite result obtained.⁶⁸ Thus the test was whether a grant was more properly classified as compensation or a gift.⁶⁹

The Internal Revenue Service in 1951 attempted to set up general standards to clarify the Commissioner's position with regard to scholarships and fellowship grants.⁷⁰ Four representative examples involving recipients of fellowship grants were set forth in the ruling, but in all four cases the taxpayers were found to have received taxable income and they were not entitled to exempt any of the awards as gifts.⁷¹ The Commissioner took the position that in no case were the grants "for the training or education" of the recipients, which would have made them taxfree gifts,⁷² but rather each recipient was required by the grantor, in exchange for the grant, "to apply his respective skill and training to advance research or creative work," which made the awards received taxable income.⁷³

In most cases, the recipient of a fellowship award is involved in "training or education" and simultaneously hoping thereby "to advance research, creative work" or to do some other project or activity in exchange for his grant.⁷⁴ George W. Stone felt this way when he was

⁶⁷ The 1954 House Report stated:

When the scholarships and fellowships are granted subject to the performance of teaching or research services, the exclusion is not to apply to that portion which represents payments which are in effect a wage or salary.

H.R. 1337, 83d Cong., 2d Sess. 7 (1954).

⁶⁸ Gordon, "Scholarships and Fellowship Grants as Income: A Search for Treasury Policy," 1960 Wash. U.L.Q. 144, 145.

⁶⁹ Gordon, "I.R.S.'s Use of Gift-v.-Compensation Test Delays Practical Fellowship Income Rule," 13 J. Taxation 272 (1960).

⁷⁰ I.T. 4056, 1951-2 Cum. Bull. 8.

⁷¹ Mansfield, *supra* note 55, at 136.

⁷² Huberman, "Scholarships, Fellowships and Prizes," 3 Hastings L.J. 116, 118 (1952).

⁷³ Note, "Fellowship Grants Under the Internal Revenue Code of 1954," 8 Buffalo L. Rev. 286 (1959).

⁷⁴ Note, "The Taxability of Scholarships and Fellowship Grants, a Student Guide," 39 Notre Dame Law. 301, 304 (1964).

awarded his fellowship for the purpose of allowing him to devote his full time and energies to research for and the preparation of an eight-volume work on the history of London dramatic performances for the period 1660 to 1800.⁷⁵ Dissatisfied with the ruling of the Treasury and believing that the two concepts were not mutually exclusive, Stone garnered a majority of the Tax Court,⁷⁶ despite a previous Supreme Court decision in favor of the Commissioner.⁷⁷ Stone's grant was held to facilitate his further education, and thus was excludable from gross income.

Many educational institutions were anxious to find more satisfactory standards which would recognize the educational function of traditional fellowship grants and which would eliminate some of the uncertainty and divergent income tax practices.⁷⁸ The situation, therefore, in early 1954 was a confusing one. Congress recognized that the Internal Revenue Service had "not provided a clear-cut method"⁷⁹ of determining taxability, and it sought to provide rules in enacting section 117 to stabilize the law in this area.⁸⁰

Section 117 of the 1954 Code generally provides that amounts received as fellowship grants and as scholarships⁸¹ at an educational institution which, under normal circumstances, maintains both a regular faculty and curriculum, while having a regularly organized body of students in attendance,⁸² are not to be included in the recipient's gross income. The provision of the Code which excludes gifts⁸³ is specifically made inapplicable as is the provision respecting prizes and awards,⁸⁴ and while this position may raise a question of constitutionality,⁸⁵ it emphasizes the congressional intent to subject the taxation of fellowship grants and scholarships to an exclusive set of rules.

⁷⁵ Weiss, "Taxability of Scholarships and Fellowship Grants," 1963 Duke L.J. 488, 491.

⁷⁶ George W. Stone, 23 T.C. 254 (1954).

⁷⁷ *Robertson v. United States*, 343 U.S. 711 (1952). See I.T. 4056, 1951-2 Cum. Bull. 8.

⁷⁸ Mansfield, "Income from Prizes and Awards and from Scholarships and Fellowship Grants," 19 N.Y.U. Inst. on Fed. Tax 129, 137 (1961).

⁷⁹ S. Rep. No. 1622, 83d Cong., 2d Sess. 17 (1954).

⁸⁰ See Chommie, "Services Rendered, Not Donative Intent, Governs Exemption of Study Grants," 4 J. Taxation 375 (1956).

⁸¹ Int. Rev. Code of 1954 § 117(a)(1); Treas. Reg. § 1.117-1(a) (1956), as amended, T.D. 6456, 1960-1 Cum. Bull. 57-43.

⁸² Int. Rev. Code of 1954 § 151(e)(4); Rev. Rul. 57-484, 1957-2 Cum. Bull. 113.

⁸³ Int. Rev. Code of 1954 § 102. See Zucker, "Income and Expenses of Visiting and Traveling Professors," 18 Tax L. Rev. 379, 382 (1963).

⁸⁴ Treas. Reg. § 1.117-1(a) (1956), as amended, T.D. 6456, 1960-1 Cum. Bull. 43.

⁸⁵ See Magill, *Taxable Income* 346 (1936).

There are some limitations, however, on the amounts which are excluded under the general rule of section 117. If the person receiving the scholarship or fellowship grant is a candidate for a degree, he or she cannot omit from taxation that portion of the award which is compensation for part-time teaching, research, or other similar activity.⁸⁶ This rule applies even though such teaching is made a condition to the grant of the scholarship, unless such part-time research, teaching, or other activity is required by the curriculum for all candidates for that degree.⁸⁷ The criterion for determining how much to include in gross income is what is usually paid for similar services to an individual who is not an award recipient.⁸⁸ The fact that the individual receiving the grant is required to furnish periodic reports to the grantor regarding his progress is not deemed to constitute performance of services in the nature of part-time employment.⁸⁹

In contrast to degree candidates,⁹⁰ nondegree candidates have much more extensive and complicated limitations.⁹¹ If the recipient is not a candidate for a degree, the payments are still excludable from gross income if the grantor is either a governmental agency or a tax exempt private organization as defined in section 501(c)(3);⁹² but the amount is limited to 300 dollars a month for a maximum period of 36

⁸⁶ Oliver, "Treatment of Fellowship Grants Under the Federal Income Tax," 43 Am. Ass'n Univ. Prof. Bull. 65 (1957).

⁸⁷ Int. Rev. Code of 1954 § 117(b)(1). See generally Chommie, *supra* note 80, at 376.

⁸⁸ Treas. Reg. § 1.117-2(a)(1) (1956).

⁸⁹ *Ibid.* See Weiss, "Taxability of Scholarships and Fellowship Grants," 1963 Duke L.J. 488, 495.

⁹⁰ The Service defines a degree candidate in the following manner:

The term "candidate for a degree" means an individual, whether an undergraduate or a graduate, who is pursuing studies or conducting research to meet the requirements for an academic or professional degree conferred by colleges or universities. It is not essential that such study or research be pursued or conducted at an educational institution which confers such degrees if the purpose thereof is to meet the requirements for a degree of a college or university which does confer such degrees. A student who receives a scholarship for study at a secondary school or other educational institution is considered to be a "candidate for a degree."

Treas. Reg. § 1.117-3(e) (1956).

⁹¹ Int. Rev. Code of 1954 § 117(b)(2). See Oliver, *supra* note 86.

⁹² For a discussion of § 501(c)(3) organizations, see Brodsky & Krasnowiecki, "Comment on the Patman Report," 112 U. Pa. L. Rev. 119 (1963); Frank, "Taxation of Charitable Trusts—Section 501(c)(3) Organizations and Aspects of the Patman Report," 42 Taxes 36 (1964); Sugarman, "Charitable Giving Developments in Tax Planning and Policy," 39 Taxes 1027 (1961); Sugarman & Pomeroy, "Business Income of Exempt Organizations," 46 Va. L. Rev. 424 (1960); Toll, "Tax Problems in Connection with Contributions to Colleges," 14 U. So. Cal. 1962 Tax Inst. 859.

months.⁹³ The application of this basically simple limitation can become very complicated.⁹⁴

Although the definition of a "scholarship" clearly is "an amount paid to or allowed to, or for the benefit of, a student, whether an undergraduate or a graduate, to aid such individual in pursuing his studies," the definition of a "fellowship grant" is less clear.⁹⁵ A scholarship includes the value of contributed services and accommodations as well as any fees or charges for matriculation or tuition.⁹⁶ However, the Treasury has ruled that where a granting institution adds an allowance for dependents to the grant, the total amount received is subject to limitations on excludability; also excluded is "any amount provided by an individual to aid a relative, friend, or other individual . . . where the grantor is motivated by family or philanthropic considerations."⁹⁷

Amounts paid to aid an individual in the pursuit of study of research are "fellowship grants," and, as a practical matter, are generally applied to graduate students.⁹⁸ If the amounts paid represent compensation for past, present, or future employment services or for services which are subject to the grantor's direction or supervision, they are taxable,⁹⁹ and the award may not include any amounts paid to enable the individual to pursue studies or research primarily for the grantor's benefit. However, neither of these restrictions apply—thus qualifying the amount as a fellowship grant—if the primary purpose of the award is to further the pursuit of the education and training of the recipient in his individual capacity.¹⁰⁰

From the foregoing definitions of "scholarships," being the all-inclusive generic term applicable to student financial aid, and "fellow-

⁹³ Int. Rev. Code of 1954 § 117(b)(2)(B); Treas. Reg. § 1.117-2(b)(2)(ii) (1956).

⁹⁴ Mansfield, *supra* note 78, at 142.

⁹⁵ The Treasury Regulations define a "fellowship grant" to mean "an amount paid or allowed to, or for the benefit of, an individual to aid him in the pursuit of study or research." Treas. Reg. § 1.117-3(c) (1960).

⁹⁶ Int. Rev. Code of 1954 § 117(a)(1).

⁹⁷ Treas. Reg. § 1.117-3(a) (1956); Rev. Rul. 55-554, 1955-2 Cum. Bull. 36.

⁹⁸ Weiss, *supra* note 89, at 493.

⁹⁹ Treas. Reg. § 1.117-4(c)(1) (1956). See Gordon, "I.R.S.'s Use of Gift-v.-Compensation Test Delays Practical Fellowship Income Rule," 13 J. Taxation 272, 273 (1960).

¹⁰⁰ Treas. Reg. § 1.117-4(c)(2). See Note, "Fellowship Grants Under the Internal Revenue Code of 1954," 8 Buffalo L. Rev. 286, 288 (1959). In the case of *Wroblewski v. Bingler*, 161 F. Supp. 901 (W.D. Pa. 1958), the taxpayer, a graduate physician, was permitted to exclude \$3,400 as a fellowship over the Commissioner's argument that the stipend was payment for treating and counseling patients at the clinic. *Wroblewski* was not a candidate for a degree, but was one of a number of participants in a graduate course leading to a certificate in psychiatry.

ship grants," it should become immediately apparent that they will not be helpful in separating such educational allowances from any payments for services, gifts, prizes, and awards. Stipends for research or study are given today in many and varied forms, and while the exclusion of scholarships has not been a source of great difficulty,¹⁰¹ the determination of what constitutes a fellowship grant has resulted in litigation because of the restrictive attitude on the part of the Internal Revenue Service. It should not be overlooked that although an award may not qualify as an exclusion under section 117, it may, nevertheless, be deductible by the recipient as an educational expense.¹⁰²

It appears that the Internal Revenue Service, in practice, is reverting to its pre-1954 Code test and is still applying the test of "gift v. compensation" set out in its earlier 1951 ruling.¹⁰³ Without concerning itself primarily with the intent of the recipient who is receiving the award, it is defeating the purpose of the provision inserted in the 1954 Code to give vitality to these educational grants, and instead continues to concentrate in its interpretations on the grantor's purpose and reason for making the grant. An examination of the language of the Code and its legislative history would appear to indicate that the thrust of the Commissioner's inquiry is in the wrong direction.¹⁰⁴

In *Frank Thomas Bachmura*,¹⁰⁵ the Commissioner's Regulations were so attacked. Bachmura, a Ph.D., was engaged by a university to perform services on a research project in economics under a grant from the Rockefeller Foundation. He was a nondegree candidate who devoted three-fourths of his time to research and one-fourth to teaching. Bachmura argued that the Regulations erroneously interpreted the intent of Congress as expressed in the statute and the committee reports. The Tax Court summarily disposed of this argument, stating that the Regulations were reasonable interpretations and that the grant was in the nature of compensation for employment rather than for the furtherance of the grantee's education and training in his individual

¹⁰¹ Huberman, "Scholarships, Fellowships and Prizes," 3 *Hastings L.J.* 116 (1952). Professor Gordon says that the difficulty is still there and that "it may be said that the value of Section 117 lies not in providing a solution to the problem but rather in its recognition that scholarships and fellowships are sufficiently unique in terms of their social function and in the framework in which they are employed to merit treatment separate from that accorded gifts and compensation." Gordon, *supra* note 99, at 272.

¹⁰² Treas. Reg. § 1.162-5 (1958).

¹⁰³ What Congress has done under the 1954 Code is little more than to change the focus of attention in this area from donative intent to employment. Chommie, *supra* note 80, at 377.

¹⁰⁴ See H.R. 1337, 83d Cong., 2d Sess. 16-17, A37-A38 (1954). S. Rep. No. 1622, 83d Cong., 2d Sess. 17-18, 188-90 (1954). See also Zucker, *supra* note 83, at 382.

¹⁰⁵ 32 T.C. 1117 (1959).

capacity. The restrictive position of the Internal Revenue Service was, therefore, given considerable support by the language of the Tax Court in this case.

A recent case,¹⁰⁸ and a recent announcement of the Treasury,¹⁰⁷ however, present a glimmer of hope for grant recipients. In *Chandler P. Bhalla*, the court held exempt a "research grant" from the National Science Foundation funds made to a candidate for a graduate degree at the University of Tennessee upon the ground that the award constituted a fully exempt "scholarship."¹⁰⁸ What makes this decision noteworthy is the fact that the Tax Court looked at the question of taxability from the point of view of the recipient of the award, rather than from the perspective of the granting organization; and if the present distinction between grants for training (excludable) and research (included and taxable) is eliminated, the use of such grants as a part of the educational process will be more consonant with the legislative policy of the 1954 Code.

THE FUTURE ECONOMICS OF LEGAL EDUCATION

It has been statistically indicated that 69 percent of the children presently below eighteen years of age are expected by their parents to go to college.¹⁰⁹ While this figure must be discounted to allow for the pride and optimism of most parents, it does demonstrate that a college education has come to be widely regarded in our society as the *sine qua non* of personal success, just as the high school education was years ago. We can expect that a growing number of qualified young people will seek a college education.¹¹⁰ Calculations indicate that by 1970, an annual expenditure of 10 billion dollars must be made if higher education is to meet the surging demand with a quality product.¹¹¹

As we have already noted, comparatively few opportunities for financial support of legal study exist because of the lack of funds available for law scholarships.¹¹² The sciences and engineering provide far

¹⁰⁸ *Chandler P. Bhalla*, 35 T.C. 13 (1960).

¹⁰⁷ T.I.R. 482, 1963 Int. Rev. Bull. No. 25.

¹⁰⁸ Prior to *Bhalla*, the Service had been quite ready to qualify "training grants" for the exclusion, while governmental and private "research grants" were generally considered to result in the receipt of taxable income. Grants were disqualified because of the rendering of required services. Note, "The Taxability of Scholarships and Fellowship Grants: A Student Guide," 39 Notre Dame Law. 301, 307 (1964).

¹⁰⁹ Coombs, "An Economist's Overview of Education," *Financing Higher Education: 1960-1970*, 15 (1959).

¹¹⁰ U.S. Department of Commerce, Bureau of the Census, "Current Population Reports, Population Estimates, Illustrative Projections of the Population of the United States, by Ages and Sex, 1960 to 1980," Series P-25, No. 187 (Nov. 10, 1958).

¹¹¹ Coombs, *supra* note 109, at 2.

¹¹² Dean Griswold of the Harvard Law School has said:

more financial aid to their entering graduate students. However, it has been noted that one of the reasons for the scarcity of such money in the law schools is that they have the highest proportion of their student enrollment coming from relatively affluent families.¹¹³

It has been estimated that if law colleges were to continue to graduate the same percentage of total enrollments as of 1957, the number of persons "will more than double during the next fifteen years."¹¹⁴ In general, law schools have thus far been able to postpone consideration of the enrollment problem, but some of the law schools in Florida and Michigan have recently changed their calendars.¹¹⁵ Law school enrollments will no doubt move sharply upward in the later 1960's.

While a much higher proportion of law students will be enrolled in state-supported law schools with modest tuitions, and although many of them will probably live at home, their parents will still be under financial pressures to assist their children in obtaining a law degree. Despite the affluence of many parents of law students, many students need substantial amounts of financial aid at the present time.¹¹⁶ However, much more detailed and reliable information is needed before any judgment can be formed as the extent of the need.

Financing a college education, despite rising incomes, is becoming a serious problem for more and more families. College fees are rising and larger numbers of students are coming from lower and middle-income families. For the typical middle-income family, the total cost of a residential college education for two children approximates two

We think little of putting \$10,000,000 or more into a cyclotron, while my school [Harvard] has for years had extreme difficulty in raising \$25,000 a year to cover the costs of a remarkable and productive basic research into the causes of juvenile delinquency and the effectiveness of present methods of dealing with that vastly important problem.

Griswold, "Educating Lawyers for a Changing World: A Challenge to Our Law Schools," 37 A.B.A.J. 805, 808 (1951).

¹¹³ Lawyers in the making: The 1961 Entrants to American Law Schools 73 (Warkov ed. 1963); Toepfer, "Tomorrow's Lawyers—Cause for Concern?" 48 A.B.A.J. 945, 946 (1962).

¹¹⁴ Joiner, "The Coming Deluge: How Goes Our Ark?" 9 J. Legal Ed. 466, 472 (1957). See also Hervey, "Law School Registration, 1962," 15 J. Legal Ed. 210 (1962).

¹¹⁵ Cavers, "A Proposal: Legal Education in Two Calendar Years," 49 A.B.A.J. 475 (1963). Professor Cavers predicts marked increases in evening law courses. The matter of part-time legal education has been the subject of a great deal of concern and soul-searching by legal educators. See American Ass'n of Law Schools, Program and Reports of Committees, Report of Special Committee on Part-time Legal Education 127 (1961). See also Tinnelly & Cheatham, Part-time Legal Education—A Study of the Problems of Evening Law Schools (1957).

¹¹⁶ See generally Nicholson, *The Law Schools of the United States* (1958).

years of income.¹¹⁷ When more than one child is in college, the payment of the full amount out of current income during a four-year period is usually impossible. While we have indicated the highest proportion of law student enrollment comes from the relatively affluent families, we must add the cost of an additional three-year period to the pre-legal investment already incurred, which tends to have an offsetting effect for both groups.

In recent years, a great deal of effort has gone into surveys among high school graduates to find out how many able students do not go on to college and why they do not.¹¹⁸ In general, these studies have shown that the probability of a student's going to college is strongly related to his ability, his sex, and his parents' education or occupation.¹¹⁹ It would also seem that there are more brilliant children who have been unable to obtain college educations due to family financial hardship.¹²⁰

The American consumers may know how to spread the cost of their home or auto, but most of them have not yet learned how to finance what is perhaps the most important *investment* they will ever make—a college and law school education.¹²¹

Financial institutions are attempting to develop new financial practices to facilitate student borrowing for law school training,¹²² but students are reluctant to saddle themselves with a fixed repayment obligation. To a lesser extent, potential lenders have been reluctant to make investments where the risk is so highly variable and subjective and where arrangements for repayment over a long period of years are so tenuous and potentially costly. Many of our larger universities find that student loans are going begging, which seems to indicate that some-

¹¹⁷ Coombs, *supra* note 109, at 28.

¹¹⁸ The most important national study is reported in Cole, Encouraging Scientific Talent, New York College Entrance Examination Board 1956; Educational Testing Service, Background Factors Relating to College Plans and College Enrollment Among Public High School Students (April 1957).

¹¹⁹ Rivlin, "Research in the Economics of Higher Education: Progress and Problems," *Economics of Higher Education* 357, 374 (Mushkin ed. 1962).

¹²⁰ *Hearings Before the Committee on Ways and Means, House of Representatives, General Revenue Revision*, 83d Cong., 1st Sess., pt. 1, 187 (1953). It is estimated that only one-half of the upper 30% in high school graduating classes finish college. See Golsom, "Who Should Pay for American Higher Education?" *Economics of Higher Education* 195, 199 (Mushkin ed. 1962).

¹²¹ Coombs, *supra* note 109, at 29. See Meck, "The Tax Credit Proposal," *Higher Education in the United States: The Economic Problems* 76, 95 (Harris ed. 1960).

¹²² See generally Eckaus, "Education and Economic Growth," *Economics of Higher Education* 102 (Mushkin ed. 1962); Vickrey, "A Proposal for Student Loans," *Economics of Higher Education* 268 (Mushkin ed. 1962).

thing is wrong with the terms on which these loans are being made available.¹²³

The problems of financing legal education relate to the law school itself as well as the student. On the one hand, financial aid to the institution may be used to reduce the costs that are passed on to the student; on the other, financial aid to the student may be passed back to the school to defray costs. In either case the aid would seem to be used to meet the same costs.¹²⁴

Most colleges and law schools have only the roughest idea of the actual costs of rendering their various educational and noneducational services. Although tuition charges continue to go up for students in both publicly and privately sponsored institutions, higher education in the United States is poorly financed at the present time.¹²⁵ This is most strikingly attested by authoritative findings that its faculty members—who are its most critical element—are on the average only about half as well paid as they should be.¹²⁶

There is no single "right formula" for the successful financing of legal education in the United States. To get the job done tolerably well, many different methods must be used to meet the problems of an enormous diversity of legal institutions with widely varying academic and financial requirements.

FEDERAL TAXATION OF LEGAL EDUCATION

A recent decision may prompt Congress to take further action to codify a clear and unambiguous construction of the Internal Revenue

¹²³ The National Defense Education Act, passed during the closing days of Congress in 1958, provides long-term student loans administered by educational institutions with 90% of the funds being advanced by the federal government, permitting needy students to stay in college once they get there. It has been recommended that the present feature which forgives indebtedness up to 50% of the loans to those who become public school teachers should be extended to include all school and college teachers. Golsom, *op. cit. supra* note 120, at 200.

¹²⁴ *But see* Millett, *Financing Higher Education in the United States* 417 (1952), where it is pointed out that there "is a great difference in procedure and implication, however, between programs which give financial aid to the individual student and those which aid the educational institution."

¹²⁵ Coombs, *supra* note 109, at 2. Law Schools throughout the United States are suffering from financial starvation. Harno, *Legal Education in the United States* 134 (1953).

¹²⁶ The President's Committee on Education Beyond the High School estimated in 1957 that the average faculty salaries would have to be increased by 75-80% to restore teaching to a competitive position in the professional labor market; to maintain this position, once restored, would require additional increases. The Committee recommended doubling the average salaries in 5-10 years. U.S. President's Committee on Education Beyond the High School, *Second Report to the President* 6 (1957).

Code and Treasury Regulations relating to the deductibility of expenses leading to a law degree.¹²⁷ In *Welsh v. United States*¹²⁸ an Internal Revenue agent enrolled as a degree candidate at a night law school. He claimed expense deductions on his income tax returns for amounts expended during the three-year period for tuition and books. The taxpayer was admitted to the Ohio Bar in June 1960. Shortly thereafter, he left the employ of the Treasury Department for a position in private law practice. The Commissioner disallowed the taxpayer's claim for refund on the theory that the expenses were incurred for the primary purpose of obtaining a new skill. The district court held that since the taxpayer's primary motive was to improve and maintain his existing skills, his educational expenses were deductible.

In recent years, the Internal Revenue Service has taken the position that expenditures for expenses in undertaking law courses that result in the taxpayer receiving a Bachelor of Laws degree are not deductible, contending that the expenditures are personal in nature and undertaken to acquire a new skill.¹²⁹ The deduction is denied whether or not the taxpayer's employer requires the taxpayer to obtain an undergraduate degree.¹³⁰

The Tax Court in *Louis Aronin*¹³¹ refused the tax deduction for a legal education to a labor management relations examiner employed by the National Labor Relations Board where there was no job requirement calling for a legal education since it also found the expenditures were undertaken to acquire a new skill not required by the employer. In *Sandt v. Commissioner*,¹³² a research chemist, who took law school courses to qualify for promotions to patent chemist, could not deduct

¹²⁷ Note, "Deductibility of the Expenses of Obtaining a Law Degree," 17 U. Miami L. Rev. 424 (1963).

¹²⁸ 210 F. Supp. 597 (N.D. Ohio 1962). See generally Comment, "Law School Education Expenses After *Welsh v. United States*," 11 Loyola L. Rev. 307 (1963).

¹²⁹ Note, "Income Tax Deduction of Educational Expenses," 11 U. Fla. L. Rev. 329, 336 (1958).

¹³⁰ Rev. Rul. 60-97, 1960-1 Cum. Bull. 69. In example (10) a trust officer in a bank undertook to study law. Although the Treasury concedes that the law will be helpful in discharging the duties of the trust officer, the taxpayer is pursuing a complete course of education in law which will lead toward qualifying in a new field and thus may not deduct his school expense. What if the bank imposed this legal training upon him as a condition of his continued employment? The Treasury, in example (10), says it is still not deductible "because the requirement is considered to be imposed primarily for the employee's benefit and not primarily for a bona fide business purpose of the employer."

¹³¹ 20 CCH Tax Ct. Mem. 909 (1961).

¹³² 303 F.2d 111 (3d Cir. 1962), *affirming* Bernd W. Sandt, 20 CCH Tax Ct. Mem. 913 (1961). *Accord*, John Lezdey, T.C. Memo 1964-78; Robert H. Montgomery, T.C. Memo. 1964-101.

the law school expenses because the Third Circuit Court of Appeals, in affirming the decision of the Tax Court, believed the costs to be personal in nature and not required by the taxpayer's employer. Certified public accountants have been denied¹³³ and granted¹³⁴ a deduction for the costs of books and law school courses.

Despite the new favorable decision in *Welsh* supporting the position of the taxpayer (the holding has been affirmed by the Sixth Circuit Court of Appeals¹³⁵), there have since been other cases which reiterated the fundamental position of the Commissioner denying such deductions. An Internal Revenue agent, James J. Engel, had his expenses of a legal education disallowed¹³⁶ on grounds that becoming a lawyer was not required by the Treasury Department of persons in the classification of field examiner.¹³⁷ In *James J. Condit*,¹³⁸ a construction company employee who handled workmen's compensation claims and negotiated supply contracts, was denied a deduction for his legal education expenses. Although the taxpayer maintained that his legal studies were for the primary purpose of improving his present skills, the Tax Court found that his principal purpose was that of becoming a lawyer. The Sixth Circuit affirmed the Tax Court's denial of the deduction on the same day that it affirmed *Welsh* in granting the legal education tax deduction to the taxpayer.

In addition to the Treasury Regulations issued by the Internal Revenue Service dealing with the deductibility of education expenses generally,¹³⁹ a ruling has also been promulgated which states that a course of study leading to a Bachelor of Laws degree qualifies a taxpayer in a new trade or business or specialty and that such education will be considered as having been undertaken to qualify the taxpayer in a *new* trade or business or specialty.¹⁴⁰ It now appears, however, that *Welch* will add to the confusion by making the deductibility of

¹³³ Anthony E. Spitaleri, 32 T.C. 988 (1959).

¹³⁴ Walter T. Charlton, T.C. Memo 1964-59.

¹³⁵ *Welch v. United States*, 329 F.2d 145 (6th Cir. 1964), *affirming* 210 F. Supp. 597 (N.D. Ohio 1962).

¹³⁶ James J. Engel, 21 CCH Tax Ct. Mem. 1302 (1962).

¹³⁷ *Contra*, Douglas R. Fortnery, 64-1 U.S. Tax Cas. § 9489. The educational expenses of an examiner in the Estate and Gift Tax Division of the Internal Revenue Service in taking a summer course in tax accounting and attending law school were held to be deductible since the education was undertaken to maintain and improve his skill as an examiner in the Estate and Gift Division. The district court also held that a legal education was customary for those qualifying as examiners in the Estate and Gift Division, but that taxpayer's particular grade as an examiner did not require a law degree.

¹³⁸ 21 CCH Tax Ct. Mem. 1306 (1962), *aff'd*, 64-1 U.S. Tax Cas. § 9317.

¹³⁹ Treas. Reg. § 1.162-5 (1958).

¹⁴⁰ Rev. Rul. 60-97, 1960-1 Cum. Bull. 69.

legal education expenses depend primarily on the subjective intent of the taxpayer. Now legal education is nondeductible *except* in the case of bank trust officers, certified public accountants, insurance adjusters,¹⁴¹ patent lawyers, chemists, and other persons who are engaged in occupations in which the knowledge of the law would be helpful, not required.

Every tax exemption has been said to be equivalent to a government expenditure, and it has been suggested that each new tax "loop-hole" should be charged against the budget of the appropriate department of government.¹⁴² In any event, we should recognize the need for extraordinary justification if a new deduction is to be allowed.

In recent years many proposals have been advanced for deductions or credits under the income tax law for certain educational expenditures.¹⁴³ Most of these proposals are intended to grant tax relief to parents of college students. In 1953 the House Ways and Means Committee selected college and education expenses as one of the forty topics for study in preparation for revision of the Internal Revenue Code.¹⁴⁴ The President's Committee on Education Beyond the High School recommended in 1957 that:

the Federal revenue laws be revised, with appropriate safeguards, in ways which will permit deductions or credits on income tax returns by students, their parents or others, who contribute to meeting the expenditures necessarily incurred in obtaining formal education beyond high school; and further, that provisions be included which will grant proportionately greater tax benefit to those least able to afford these expenditures.¹⁴⁵

Both major political parties included in their 1960 platforms a statement favoring consideration of means through tax laws to help offset tuition cost without specifying the form of assistance.¹⁴⁶

As mentioned above, our tax laws make no provision for current or future deductions for expenditures incurred for education or training undertaken to prepare oneself for a vocation or profession, or to

¹⁴¹ Richard M. Baum, 23 CCH Tax Ct. Mem. 200 (1964).

¹⁴² McKenna, "Tax Loopholes: A Procedural Proposal," 16 Nat'l Tax J. 63, 65 (1963).

¹⁴³ Note, "Federal Tax Incentives for Higher Education," 76 Harv. L. Rev. 369, 379 (1962).

¹⁴⁴ *Hearings Before the Committee on Ways and Means, House of Representatives, General Revenue Revision*, 83d Cong., 1st Sess., pt. 1, at 177-201 (1953).

¹⁴⁵ President's Committee on Education Beyond the High School, Second Report to the President 11 (1957).

¹⁴⁶ Roberts, 1960 Platforms of the Democratic and the Republican Parties 68 (U.S. House of Representatives, September 1960).

meet the minimum requirements for any employment. The Code¹⁴⁷ and Regulations,¹⁴⁸ while permitting expenditures for certain kinds of supplementary continuation or refresher courses previously illustrated, have created confusion in this oft-litigated area and this uncertainty has prompted requests for clarification and tax reform.¹⁴⁹ While deductions will ordinarily be allowed for the cost of education for maintaining or improving skills,¹⁵⁰ the taxpayer must first determine whether it is customary for other established members of the taxpayer's trade or business to undertake such education.¹⁵¹

THE CAPITALIZATION AND AMORTIZATION OF THE EXPENSES OF LEGAL EDUCATION

Our Government has too long delayed in doing the fair and just act of placing professional people on the same basis as business and industry.¹⁵² The income tax laws are presently at variance from the commonly accepted and deep-rooted belief of the American people that our high standards of living and our national welfare are geared to and dependent upon our being an educated people.¹⁵³ In recent years there have been many studies and reports by distinguished bodies emphasizing the above point,¹⁵⁴ citing particularly the importance of legal education as well as graduate work in the field of higher education.¹⁵⁵

Senator Abraham Ribicoff lost a close battle in 1964 on his tax-

¹⁴⁷ Int. Rev. Code of 1954 § 162.

¹⁴⁸ Treas. Reg. § 1.162-5(a) (1958).

¹⁴⁹ Chommie, "Federal Income Taxation: Transactions in Aid of Education," 48 Dick. L. Rev. 291, 324 (1954); Harrington, "The Deductibility of Educational Expenses Under § 162(a) of the Internal Revenue Code," 4 William & Mary L. Rev. 55, 65 (1963); Loring, "Some Tax Problems of Students and Scholars," 45 Calif. L. Rev. 153, 167 (1957).

¹⁵⁰ Donald Frazee, 22 CCH Tax Ct. Mem. 1086 (1963).

¹⁵¹ Hagendorf, "Tax Court, in Watson, Interprets New Education Expense Regulations Broadly," 11 J. Taxation 226 (1959); Steutzer, "New Cases on Travel, Education, Help Draw Line Between Personal and Business," 11 J. Taxation 346 (1959).

¹⁵² See generally Kahn, Personal Deductions in the Federal Income Tax (1960).

¹⁵³ Becker, "Underinvestment in College Education," 50 Am. Econ. Rev. 346, 348 (1960); Schultz, "Investment in Human Capital," 51 Am. Econ. Rev. 1, 2 (1961).

¹⁵⁴ Auerback, *The Legal Process—An Introduction to Decision Making* (1961); Cavers, "Recent Issues in Legal Education," 11 Clev.-Mar. L. Rev. 385 (1962); Emerson, "Postadmission Education to Lawyers at Medium-Sized and Smaller Law Schools," 9 J. Legal Ed. 372 (1956); Fordham, "Legal Education and the Advancement of Law, Legal Institutions and Legal Processes," 13 J. Legal Ed. 172 (1960); Goldberg, "New Frontiers for Lawyers and the Law," 45 J. Am. Jud. Soc'y 56 (1961); Mayo, "The New Technology and National Goals: Some Implications for Legal-Policy Decision Making," 37 Notre Dame Law. 33 (1961).

¹⁵⁵ Hearings, *supra* note 144, at 180.

credit plan, but promised to renew the fight.¹⁵⁶ Under the bill, parents would have been allowed a credit against the tax of up 325 dollars a year for payment of tuition, other fees, books, and supplies.¹⁵⁷ A considerably greater part of the total tax reduction would accrue to low-income and middle-income families under a tax credit than under any deduction plan, and should cost our Government the same amount of revenue.¹⁵⁸

In addition to the tax-credit plan, it has recently been proposed that expenses of education should be permitted to be capitalized and amortized against the future earnings derived therefrom by taxpayers.¹⁵⁹

Richard Goode, a senior staff member of the Brookings Institution, appears to have revived a proposal made in 1953, permitting a tax-free recovery of educational outlays. Under the original plan an annual deduction would be allowed against employment, *e.g.*, teachers and professors, or self-employment, *e.g.*, doctors, and lawyers, income in an amount not exceeding the lesser of 10 percent of the cost or 25 percent of the actual employment income for the year involved. Any amount that would still remain after the ten years would still be available to be written off under the same rules of deduction.

Taxpayers who had already started on their careers and who were subsequently taking refresher and seminar courses¹⁶⁰ would have an option, as does business, of either fully deducting the expense in the year incurred, or adding it to the unamortized basic education expense. In order to obtain this amortization deduction, a taxpayer would be required to be employed in some field utilizing this education.¹⁶¹ In

¹⁵⁶ N.Y. Times, February 5, 1964, p. 1, col. 2. For a detailed examination of the tax-credit proposal introduced originally by John F. Meck, Vice President and Treasurer of Dartmouth College, see *Hearings Before the Committee on Ways and Means, House of Representatives, General Revenue Revision*, 85th Cong., 2d Sess., pt. 1, at 1061 (1958).

¹⁵⁷ Meck, "The Tax Credit Proposal," *Higher Education in the United States* 93 (Harris ed. 1960).

¹⁵⁸ Goode, "Educational Expenditures and the Income Tax," *Economics in Higher Education* 301 (Mushkin ed. 1962.)

¹⁵⁹ *Ibid.*

¹⁶⁰ In 1959, New York University had 750 Lawyers in attendance in one or more of the 130 graduate courses or seminars. Tweed, "Continuing Legal Education and the Law Schools," 27 Tenn. L. Rev. 338, 341 (1960); Stumpf, "Continuing Legal Education: Its Role in Tomorrow's Practice of the Law," 49 A.B.A.J. 248 (1963). Education for practicing lawyers is still in its infancy. Horowitz, "Graduate Study for the Practicing Lawyer," 4 J. Legal Ed. 196 (1951); Stumpf, "Practical Problems in Continuing Legal Education," *Prac. Law.* 8 (April 1960).

¹⁶¹ "A precise measure of earning capacity would not be required, but merely an indication whether a significant influence could reasonably be expected on the basis of the experience of other persons who have acquired similar education, or other evidence." Goode, *supra* note 158, at 287.

addition, his deduction would be limited to the amount of earnings directly attributable to this educational capital without reference to any other income that the taxpayer derives from other sources.

Emphasis is placed on the purpose of the expenditure, rather than on its merits.¹⁶² Expenditures for ordinary high school studies would be classified as personal expenses and nondeductible, but part-time studies and correspondence courses could be eligible for capitalization. Students at colleges and universities, as defined by the Office of Education, would qualify regardless of whether they obtained degrees or not.

The proposal also provides for an alternative method of treatment of this investment in "human capital."¹⁶³ The personal costs of different kinds of education could be fragmented, giving weighted values to different kinds of education with the objective of reflecting differences in the normal contribution to future earnings of the taxpayer. For example, Mr. Goode divides the proportions to be capitalized as follows: (a) 75 percent for general college and university studies, (b) 100 percent for professional schools, postgraduate courses, and vocational training, and (c) 25 percent for high school courses.

Although foregone earnings of students are a large part of the real cost of education,¹⁶⁴ these earnings which students do not realize while they are attending school would not be added for tax purposes to the unamortized human capital accounts. However, in lieu thereof, a small fixed allowance for additional living expenses might be permitted to students living away from home and attending nonresidential colleges or universities. No deduction would be granted for normal living expenses since these would be incurred in any event.

The deduction could be allowed in full, if the taxpayer should die before the end of the amortization period, in the same manner as we now permit depreciable property to be written off when it suddenly loses its usefulness.¹⁶⁵ Should the deduction in such cases reduce the income of the decedent's estate or of the decedent to below zero, a carry back or net loss might be authorized and a refund of income taxes for previous years granted. The same equitable and nondiscriminatory treatment of human investment could be justified in those cases where the taxpayer became totally and permanently disabled.

While Mr. Goode admits that the adoption of his plan allowing educational expenditures to be written off against taxable income would

¹⁶² Professor Theodore Schultz, of the University of Chicago, however, suggests that educational expenditures be classified by reference to their influence on earnings rather than by reference to their outlay. Schultz, *supra* note 153, at 2.

¹⁶³ Goode, *supra* note 158, at 290.

¹⁶⁴ Schultz, "Capital Formation by Education," 68 J. Pol. Econ. 571 (1960).

¹⁶⁵ Int. Rev. Code of 1954 § 167; Treas. Reg. § 1.167(a)-8 (1956).

probably encourage colleges and universities to raise their tuition charges and fees, which is the argument that was made in the Senate by the opponents of Senator Ribicoff's tax credit proposal, he points out that it is not until tuition and fees are increased to cover a much larger fraction of the total educational costs, that the amortization plan would become more significant. Since the United States Office of Education reported that tuition and fees alone, between 1940 and 1957, increased 89 percent in public colleges and 83 percent in private colleges,¹⁶⁶ it does not appear we shall have too long to wait.

CONCLUSION

Basic legal education may be presumed to be motivated primarily by economic considerations, and the same may be said of a refresher course and any supplementary postgraduate training relating directly to the practice of law. The connection between such legal education and earning capacity is fairly clear, and current deduction or amortization could properly be allowed so long as the amounts are reasonable.

The recognition that certain investments in human capital should be treated, for tax purposes, in a similar and like manner to investments in physical assets would help to establish an important principle that is often overlooked—a modern nation, to prosper, needs a tax-supported school system. Congress has already shown us that it is quite able to solve the problem of the indefinite and uncertain useful life in some of the other areas of expense deductions. It has discretion to award lawyers, doctors, teachers, and other professionals artificial, amortizable lives.

If it seems strained to treat educated labor as a capital factor, we need only look to the dictum of Mr. Justice Cardozo. He saw the analogy of the educational investment to the physical capital utilized in other areas of endeavor. Perhaps education is more durable than many forms of nonhuman reproducible capital.

The men who shaped our Constitution clearly felt that federal aid to higher learning was compatible with our form of government. No better use can be made of public funds than to establish and support better educational facilities, and to assist students to take greater advantage of our institutions of learning. To obviate the danger of depletion in the ranks of professionals, we suggest that the public cost of their education, already great, must become even greater. For this, the government must prepare. The alternative is even less desirable.

¹⁶⁶ Hearings, *supra* note 120, at 1062.